

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



June 13, 2002

Agenda ID 776
Alternate Order to 510
H-5 from 6/6/2002

TO: PARTIES OF RECORD IN APPLICATION 01-03-026

Enclosed is the Alternate Proposed Decision of Commissioner Loretta Lynch to the Proposed Decision of Administrative Law Judge (ALJ) Jeffrey O'Donnell previously mailed to you.

When the Commission acts on this agenda item, it may adopt all or part of it as written, amend or modify it, or set aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

As set forth in Rule 77.6(d), parties to the proceeding may file comments on the enclosed alternate at least seven days before the Commission meeting or no later than June 20, 2002. An original and four copies of the comments with a certificate of service shall be filed with the Commission's Docket Office and copies shall be served on all parties on the same day of filing. The Commissioners and ALJ shall be served separately by overnight service.

Carl K. Oshiro, Interim Chief
Administrative Law Judge

Decision **ALTERNATE PROPOSED DECISION OF COMMISSIONER LYNCH**
(Mailed June 13, 2002)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of PacifiCorp
(U-901-E) for an Order Authorizing an Immediate
Interim Rate Increase, Subject to Refund and for
Consideration of a Rate Stabilization Plan.

Application 01-03-026
(Filed March 16, 2001)

James C. Paine and James Van Ostrand, Attorneys at Law, for
PacifiCorp, applicant.

John M. Chamberlain, Attorney at Law, for the Office of Ratepayer
Advocates; S. Bradley Van Cleve, Attorney at Law, for Roseburg
Forrest Products; and Mary Francis Mc Hugh, Deputy Siskiyou
County Counsel, for Siskiyou County; interested parties.

INTERIM OPINION

I. Summary

PacifiCorp seeks an end to the rate freeze imposed by Assembly Bill (AB) 1890 (Stats. 1996, Ch. 854), a one-cent per kilowatt-hour (kWh) interim rate increase, and a valuation of its generation assets at net book value if the Commission determines that such a valuation is needed. In this interim opinion, we find that a rate increase is warranted. We grant an interim rate increase of one-cent per kWh, except that the resulting interim rates may not exceed the corresponding rates requested in the general rate increase filing. The interim rate increase will be subject to refund with interest, and implemented as a surcharge.

II. Background

The Commission implemented AB 1890 for PacifiCorp by Decision (D.) 97-12-093. In the first phase of this application, PacifiCorp asks for a determination that its transition period has ended, requests a one-cent per kWh interim increase, subject to refund with interest, applicable to all of its California ratepayers, and asks that its generation assets be valued at the net book value if a valuation is needed. In the second phase of the application, a general rate increase and related matters will be addressed.

In Resolution ALJ 176-3060 dated March 27, 2001, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that hearings were necessary. Hearings were held on August 22 and 23, 2001. Briefs were filed, and the matter was submitted.

III. Test Year

In its application, PacifiCorp used 12 months ended September 30, 2000 as a test year. PacifiCorp says that, given the short time it had to respond to its financial situation and the information it had available, it believes this test year period is reasonable for interim relief. The Commission's Office of Ratepayer Advocates (ORA) says that, since PacifiCorp's test year is more than 15 months old, the Commission should be very cautious in deciding what weight to give PacifiCorp's test year evidence. Roseburg Forrest Products (Roseburg) recommends that the Commission reject PacifiCorp's test year because it is unreasonably flawed, and will have no credible relationship to the period the interim rates would be in effect. Siskiyou County (Siskiyou) echoes Roseburg's objections.

The application was filed on March 16, 2001, five and a half months after the end of the test year period. We do not find this to be an unreasonable

amount of time in which to gather and finalize the recorded information for the test year, analyze the data, and prepare the application. Therefore, we will utilize PacifiCorp's test year.

IV. Financial Status

PacifiCorp prepared its test year results by making adjustments to the recorded results for the test year. The primary issue between the parties regarding the test year operating costs is net power costs. PacifiCorp estimated its test year net power costs based on data for June through September 2000. The result was \$760 million on a total company basis. PacifiCorp believes that actual 2001 net power costs will be higher because of its previously executed contracts for 2001 power purchases. Actual net power costs for the first six months of 2001 were \$561 million.

Roseburg provides adjustments to PacifiCorp's estimate that would lower the test year total company power costs to \$138 million. However, Roseburg does not estimate that PacifiCorp's costs will be \$138 million. Instead, it says that its adjustments demonstrate that PacifiCorp's estimates are flawed. Roseburg says that it is nearly impossible to adjust PacifiCorp's test period to accurately reflect costs during the first half of 2002.

PacifiCorp argues that Roseburg's adjustments were selective, one-sided adjustments to the test period. If the Commission were to consider them, it would also have to adjust all of the other cost and revenue elements of the summary of earnings such as load, fuel expenses, ratebase, etc.

PacifiCorp is correct in saying that Roseburg's adjustments do not include all cost and revenue elements. In addition, Roseburg's adjustments are illustrative of its view that PacifiCorp's estimates are flawed, as opposed to specific recommended adjustments. However, we find some merit in Roseburg's

arguments, such as the adjustment of power sales contracts that expire before 2002. PacifiCorp's 1999 actual net power costs, \$432 million on a total company basis, were more in line with historical power costs than its test year estimate. Basing PacifiCorp's test year California results of operations on 1999 actual net power costs yields a return on equity of 1.2% for California operations. This is close to PacifiCorp's actual total company return on equity for the test period of 1.166%. We note that the Oregon and Utah Commissions recently adopted total company net power costs of \$595 million and \$589 million, respectively for similar test periods. We are also mindful of the fact that the requested increase is for interim rates. The test period summary of earnings has not been as thoroughly investigated as it would be in a general rate case. Therefore, for the purpose of considering an interim increase, we will be conservative and assume PacifiCorp's test year results of operations based on 1999 actual power costs. As a result, the test year return on equity is 1.2% for California operations. PacifiCorp says a one-cent per kWh increase, based on test year results of operations using 1999 actual power costs, would result in a 5.8% return on equity. No party disputed this calculation, and we will use it to estimate the impacts of a rate increase on PacifiCorp's earnings for 2002.

V. Use of California Jurisdictional Operations

PacifiCorp bases its request on California jurisdictional operations. ORA, Roseburg, and Siskiyou say that company-wide operations should be used in determining whether an interim rate increase is necessary. Historically, we have set rates based on California jurisdictional operations. If we were to do as ORA and the other parties suggest, we would base a determination of whether an interim increase is needed on total company operations. In other words, if the total company is financially healthy, California rates need not be increased

regardless of whether the results of operations for California demonstrate that California ratepayers are paying the full costs of the service they receive, including a reasonable return.

Typically, California rates should be set based on California operations. California ratepayers should not subsidize other states, nor should they be subsidized by them. However, the issue at hand is whether a financial emergency exists which warrants the unusual actions of an interim rate increase. To determine the nature of the financial status of PacifiCorp, it is appropriate to look at the results of the company as a whole. This does not mean that the more normal task of setting rates in a general rate case should deviate from the use of California specific results.

VI. Transition Period

PacifiCorp established its Transition Cost Balancing Account (TCBA) in May 1998. It says that it sold power under frozen rates that exceeded revenues in May and June 1998, and March 1999. The amount that revenues exceeded market price levels was \$846,574 for those three months. In every other month, PacifiCorp has sold power at less than market prices. The balance in the TCBA was an undercollection of \$72,146,444 as of February 2001. PacifiCorp does not expect to collect any additional transition costs by March 31, 2002. It says that it has collected all of the transition costs it is going to collect. Therefore, it believes that the transition period is over.

ORA interprets Pub. Util. Code § 368(a) to mean that the transition period cannot end until the TCBA rises to zero, or a positive number. ORA contends that this is unlikely, therefore, PacifiCorp must wait until April 1, 2002 for the freeze to end. Roseburg also believes that the transition period cannot end until the TCBA rises to zero or a positive number. In addition, it says that the freeze

should not end until PacifiCorp has no transition costs that will be carried over, or March 31, 2002.

Section 368 of the Public Utilities Code established a rate freeze that set retail rates equal to those in effect on June 10, 1996, less 10% for residential and small commercial customers. These rate levels were to remain in effect until “the earlier of March 31, 2002, or the date on which the Commission-authorized costs for utility generation-related assets and obligations have been fully recovered.”

PacifiCorp asserted that the rate freeze for it has ended because it has recovered all of the transition costs, the uneconomic portion of its investment in generation-related assets, that it is going to recover. Furthermore, PacifiCorp is not seeking recovery of the negative TCBA balance in this proceeding.

“‘Transition costs’ means the costs, and categories of costs, of an electrical corporation for generation-related regulatory assets, nuclear settlements, and power purchase contracts, ... , that were being collected in commission-approved rates on December 20, 1995 and that may become uneconomic as a result of a competitive generation market in that those costs may not be recoverable in market prices in a competitive market, ...”
Section 840(f), Public Utilities Code.

To constitute “transition costs,” a utility’s generation-related assets and obligations must have been a component of Commission-approved rates on December 20, 1995, and must be an asset or obligation that may become uneconomic or unrecoverable in a competitive market.

Section 367(b) of the Public Utilities Code provides that transition costs are based on a calculation that nets the negative value of “above market utility-owned generation related assets against the positive value of all below market utility-owned generation assets”, for those assets subject to such valuation.

Valuation was to occur no later than December 31, 2001 and was to be based on appraisal, sale, or other divestiture.

PacifiCorp has not recovered transition costs. Its position is that, under the circumstances reflected in this proceeding, the market value of its generation assets is their net book value, consistent with traditional cost of service ratemaking. ORA does not dispute this valuation. We agree that this approach is consistent with ABX 16 (Stats. 2001, First Extraordinary Session, Ch.II).

When this proceeding began, to obtain rate relief, PacifiCorp had to show that its rate freeze had ended. To this purpose, it produced evidence that it had no transition costs to recover and, therefore, the rate freeze was over. However, we need not resolve this issue because the March 31, 2002 date for termination of the rate freeze has passed, and the transition period has ended.

VII. Legal Standard For Granting Interim Relief

PacifiCorp cites several court cases and Commission decisions that demonstrate that the Commission may grant interim relief when:

- A financial emergency exists (and a showing that utility results of operations fall below an authorized rate of return, and the utility has been subject to increased costs, constitutes a financial emergency), or
- Fairness to both the utility and the public require immediate action, or
- Future increases are contemplated and a gradual increasing of rates will avoid rate shock, or
- Interim relief would arrest a downward trend in interest coverage, and enhance the utility's ability to attract capital at reasonable terms.

ORA and Roseburg argue that the Commission can only grant interim relief if a financial emergency exists. They maintain that a financial emergency exists when the utility faces an imminent inability to satisfy its fiscal responsibilities and/or discharge its obligation to serve. Siskiyou contends that the Commission may grant interim relief when there is a financial emergency or,

where no emergency exists in the sense of a threat to the utility's survival, when fairness to both the utility and the public require immediate action.

The Commission's authority to grant interim rate relief under the circumstances of this proceeding is well established. In *Toward Utility Rate Normalization v. Public Utilities Commission*, 44 Cal. 3d 870, 750 P. 2d 787, 256 Cal. Rptr. 8 (1988), *Toward Utility Rate Normalization* (TURN) contended that the Commission could not authorize interim relief unless failure to do so would result in a financial emergency or unless the reasonableness of the investment costs covered by the utility's rates is undisputed. The Supreme Court recognized that the Commission has granted interim relief under the standards cited by TURN, but stated:

"From the existence of those two exceptions, however, it does not follow that no other circumstances can justify an interim increase." 44 Cal. 3d at 875.

The Supreme Court continued:

"The commission's power to grant interim rate increases was recognized by this court in *City of Los Angeles v. Public Utilities Commission* (1972), 7 Cal. 3d 331, [01 Cal. Rptr. 313, 497 P. 2d 785]. There we annulled a commission order granting a general rate increase to Pacific Telephone but provided that the commission 'may grant interim rate increases should it find them appropriate while it reconsiders Pacific's application for rate increase,' ... It is apparent that the authority delegated to this commission by the Public Utilities Act to award rate relief to a public utility carries with it the incidental and implied power to grant interim relief, if the facts warrant such summary relief." (*Id.* at p. 878.)

"In the present case, the commission was not faced with an 'emergency' in the sense of a threat to the utility's survival, but

the situation was one in which fairness to both the utility and public required immediate action.” (44 Cal. 3d at 879.)

In granting a substantial interim rate increase to Southern California Edison Company in 1988, and in response to the contention that it had not made a case justifying interim relief, the Commission said:

“We disagree with these parties and find that several factors in fact support our granting such relief for Edison. None of these factors suggest the existence of an emergency, but all relate to preserving the financial integrity of the utility, minimizing costs incurred by ratepayers, and ensuring rate stability for Edison’s customers. As mentioned previously, however, the existence of a financial emergency is no longer a standard which must be met in granting interim relief.” (D.88-05-074, p. 14.)

Thus, the utility’s continued viability need not be on the line before interim rate relief may be granted. *Re California Utilities Services, Inc.*, (D.91-02-035.) It is sufficient “where there is a showing that fairness to both the utility and the public require immediate action.” (D.91-02-035 at p. 10, citing *TURN v. PUC* 44 Cal. 3d 870, 879.)

As previously discussed, we have estimated that the test year rate of return on equity is 1.2% for California jurisdictional operations at present rates, if net procurement costs are the same as in 1999, \$432 million. This means that we forecast that PacifiCorp has a reasonable opportunity to earn a rate of return on equity of 1.2% at present rates. This is well below the reasonable rate of return adopted by the Commission for PacifiCorp.

With the requested rate increase, PacifiCorp would have a reasonable opportunity to earn a rate of return of 5.8% on equity. No party has suggested that a 5.8% return on equity would be unreasonable. A return on equity of 5.8%

is not excessive.¹ Therefore, a one-cent per kWh rate increase designed to achieve such a return is not inherently unreasonable.

PacifiCorp has filed a general rate increase application for which no decision can reasonably be expected before the third quarter of 2002. Present rates may not allow PacifiCorp a reasonable opportunity to earn a fair return. Therefore, immediate action may be necessary.

VIII. Impact of Rate Increase

Siskiyou says that it is experiencing significant economic hardships. No party disagreed. Siskiyou argues that the proposed rate increase would be particularly hard on PacifiCorp's ratepayers in the county. In the past, we have considered ratepayer economic conditions in setting the authorized rate of return. In this instance, granting PacifiCorp's request would result in a return on equity of 5.8%. This is substantially below its last authorized return. We must balance the impact of the interim rate increase on ratepayers, and the need for the increase.

PacifiCorp's request would result in an average rate increase to its California customers of almost 14%. This is a tremendous increase to impose on customers. In addition, PacifiCorp proposes to apply this surcharge to CARE customers, which the Commission has not done for other utilities. These customers, as noted by PacifiCorp, will feel the brunt of this increase the most.

By imposing this burden on its California customers, PacifiCorp estimates it will increase its revenues by less than \$7.5 million annually. PacifiCorp asserts that this increase is necessary due to the potential high costs it faces to procure

¹ PacifiCorp's most recent authorized return on equity is 10.85% for 1994 (D.93-12-022).

power. However, this expected increase in revenues of under \$7.5 million is dwarfed by the range of uncertainty in PacifiCorp's procurement costs.

PacifiCorp has suggested its net power costs could be as high as \$760 million or just \$432 million if costs return to the level experienced in 1999. Other parties have suggested that with other assumptions, PacifiCorp's net power costs could be just \$138 million.

We note that PacifiCorp made its request in the spring of 2001, when market electric and gas prices were unreasonably high. Actions taken by the Governor, the State Department of Water Resources and the Commission have helped stabilize market prices and return them to much lower levels than were experienced in 2000 and 2001. It is therefore very uncertain that PacifiCorp will in fact incur the high level of net power costs which underlie its request.

Given the significant detrimental impacts of a large rate increase to PacifiCorp's customers, and the relatively small relief that it would give PacifiCorp in the event that PacifiCorp does incur high power costs, it is not reasonable to authorize an interim rate increase at this time.

We are also concerned that granting interim rate relief based solely on a forecast that the utility may not earn its authorized rate of return sets a problematic precedent. Our ratemaking policies provide that utilities may earn more than their authorized rate of return if circumstances turn out to favor the utility, and may earn less if circumstances are not in the utility's favor. Granting an interim increase as requested by PacifiCorp would upset the balance of the upside and downside inherent in our ratemaking, and provide PacifiCorp with a limited risk while retaining its full upside potential.

IX. Interim Rate Relief

As discussed above, we find that an interim increase is not appropriate at this time. However, given the uncertainty regarding PacifiCorp's 2002 net power costs, we will provide PacifiCorp with added assurance of cost recovery. We will allow PacifiCorp to establish a tracking account for its 2002 net power costs. Should those costs be greater than \$425 million (PacifiCorp's 1999 expense level less the \$7.4 million increase it seeks herein), PacifiCorp may seek recovery of the amount over \$425 million in a future application. Any such request shall be subject to a limit of the \$7.4 million it has sought herein.

This decision should be effective immediately in order to provide PacifiCorp with an opportunity to earn a more reasonable return.

X. Potential Sale to Nor-Cal Electric Authority (Nor-Cal)

PacifiCorp has announced its intention to file an Application requesting approval of a proposed sale of its California operations to Nor-Cal. If we issue a decision approving a sale before a decision is issued on a general rate increase, there will be no need for a general rate increase. We make no findings herein on whether a sale should be approved.

XI. Comments on Alternate Proposed Decision

On June 13, 2002, the alternate proposed decision (Alternate) of President Lynch was filed with the Commission and served on the parties in accordance with § 311(d) of the Pub. Util. Code and Rule 77.1 of the Commission's Rules of Practice and Procedure. Comments on this Alternate should be submitted by June 20, 2002.

Findings of Fact

1. This application was filed approximately five and a half months after the end of the test period.

2. Five and a half months is a reasonable amount of time in which to gather and finalize the recorded information for the test period, analyze the data, and prepare the application.

3. Actual total company net power costs for the first six months of 2001 were \$561 million.

4. PacifiCorp's 1999 actual total company net power costs, \$432 million, were more in line with historical power costs than its test year estimate.

5. PacifiCorp's test year results of operations based on 1999 actual total company net power costs yields a return on equity of 1.2% for California operations.

6. PacifiCorp's actual total company return on equity for the test period was 1.166%.

7. PacifiCorp's proposed one-cent per kWh increase would result in a 5.8% return on equity for the test year.

8. PacifiCorp's proposed one-cent per kWh increase would increase California customers' rates by nearly 14%.

9. Historically, PacifiCorp's rates have been set based on California jurisdictional operations.

10. With the requested rate increase, PacifiCorp would have a reasonable opportunity to earn a rate of return of 5.8% on equity.

11. A return on equity of 5.8% is not excessive.

12. PacifiCorp's general rate increase filing, which will be addressed in the second phase of this proceeding, includes some proposed rate increases that are less than one-cent per kWh.

13. PacifiCorp's proposed 1 cent/kWh increase will result in a revenue increase of under \$7.5 million annually.

14. The uncertainty of what PacifiCorp's 2002 net power costs will be is hundreds of millions of dollars.

Conclusions of Law

1. PacifiCorp's test year period is reasonable.
2. The need for an interim increase should be based on criteria established in prior Commission decisions.
3. PacifiCorp's test year results of operations based on 1999 actual net power costs should be used to estimate PacifiCorp's 2002 earnings.
4. Pub. Util. Code § 368(a) provides that the transition period shall continue until the earlier of March 31, 2002, or the date on which the Commission-authorized costs for utility generation-related assets and obligations have been fully recovered.
5. The rate freeze has ended for PacifiCorp consistent with Pub. Util. Code § 368(a).
6. Current rates may not be sufficient to allow PacifiCorp an opportunity to earn a reasonable return.
7. A one-cent per kWh rate increase is burdensome to ratepayers.
8. Immediate action is not needed.
9. PacifiCorp should be allowed to increase rates by up to one-cent per kWh, if it's net power costs are high in 2002.
10. PacifiCorp should be allowed to track its 2002 net power costs, and seek recovery of such costs if they are sufficiently high, as described herein.
11. The decision should be effective immediately in order to provide PacifiCorp with assurance that it will have an opportunity to earn a reasonable return.

INTERIM ORDER

IT IS ORDERED that:

1. PacifiCorp's request for an interim rate increase is denied.
2. PacifiCorp may establish a tracking account for its 2002 net power costs, and is allowed to seek recovery in a future application if such costs exceed \$425 million.

This order is effective today.

Dated _____, at San Francisco, California